



STATE BOARD OF EQUALIZATION  
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Executive Director

September 10, 1996

Attention: Ms.

Re: Proposition 58 Reassessment Exclusion

Dear Ms.

This is in response to your letter to me of August 8, 1996 in which you request our opinion as to whether a "change in ownership" for property tax purposes occurred and if so, to what extent under the following facts described in your letter and set forth below. For the reasons stated hereafter, we are of the opinion that no "change in ownership" occurred.

#### Factual Background

The decedent died on October 20, 1994. Her estate consisted of cash and her principal residence, all held in the ABC 1993 Family Trust. The decedent resided in the real property with her son prior to her death. The son still resides in the residence.

The Trust provides that following the decedent's death, the Successor Trustee should divide the trust estate into equal shares and distribute one share to each of the decedent's two children, a daughter and a son, free of trust. In the Trust, "trust estate" refers to "the assets listed in Schedule A and to any other property received by the Trustee." Furthermore, the Trust provides that "the Trustee is authorized to allot and make the division or distribution, pro rata or otherwise, in cash or in kind, including undivided interests in any property, or partly including undivided interest in any property, or partly in cash and partly in kind, in the Trustee's discretion." (Art. Sixth, Sec. A, p. 11.) The Trust also provides that the Trustee has the power to "encumber,

mortgage or pledge trust property for a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee." (Art. Fourth, Sec. G, p. 7.)

The Successor Trustee believed that the Trust estate had a net worth of approximately \$322,000, with the real property valued at approximately \$310,000 and all other property valued at \$12,000. Pursuant to the Trust provisions, the Successor Trustee sought to distribute approximately \$161,000 net worth of assets to each child. On April 24, 1995, before making any distributions, the Successor Trustee obtained a loan and Deed of Trust against the Trust real property for \$160,000. The assets of the Trust then consisted of cash, including loan proceeds and the real property encumbered by the Deed of Trust.

On June 2, 1995, the Successor Trustee was ready to distribute the Trust property, and made a non pro rata distribution of \$150,000 of the Trust's cash to decedent's daughter. On June 22, 1995, the Successor Trustee made a non pro rata distribution of the real property to decedent's son individually, subject to the \$160,000 loan and Deed of Trust.

On June 22, 1995, the Successor Trustee executed a proper Claim for Reassessment Exclusion for Transfer Between Parent and Child. He submitted it to the Alameda County Recorder on June 26, 1995.

The Assessor issued a Notice of Supplemental Assessment on January 12, 1996 regarding the reassessment of one-half of the real property after the death of the parent and the distribution of the real property to the decedent's son. The property was previously on the tax roll at \$47,441. The Assessor appraised it at only \$220,000, one-half of which is \$110,000. Thus, the new assessed value is \$133,441. Subtracting the \$47,441 already taxed, the Assessor issued a Supplemental Assessment to the son of \$86,000 and a supplemental tax of 1.2990% thereon, or \$1,117.14.

The Assessor has indicated that the property was reassessed because "there was not enough money in the trust estate to equally distribute cash to [the daughter]...The Trustee obtained a cash loan to distribute cash to [the daughter] instead of a 50% interest in the above referenced property." The Assessor relies heavily on a Letter to Assessor dated January 23, 1991, No. 91/08, entitled "Change in Ownership Consequences of Real Property in an Estate or Trust Distributed on a "Share and Share Alike" Basis" (LTA 91/08).

#### Law and Analysis

As you are aware, Revenue and Taxation Code<sup>1</sup> section 60 defines a "change in ownership" as "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

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<sup>1</sup> All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

Section 61 provides that, subject to exceptions not here relevant, "change in ownership, as defined in section 60, includes, but is not limited to:...(g)[a]ny interests in real property which vest in persons other than the trustor...when a revocable trust becomes irrevocable."

Proposition 58 added subdivision (h) to section 2 of Article XIII A of the California Constitution. Briefly, subdivision (h) excludes from change in ownership the purchase or transfer of the principal residence of the transferor in the case of the purchase or transfer between parents and their children. It also excludes the purchase or transfer of the first \$1 million of the full cash value of all other real property between parents and their children.

Subdivision (h) is implemented by section 63.1. Section 63.1(c)(7), in part, defines "transfer" as including any transfer of the present beneficial ownership of property from an eligible transferor to an eligible transferee through the medium of an inter vivos trust. It seems clear, therefore, that if the transfer of the decedent's principal residence to the decedent's son qualifies as a transfer from decedent pursuant to the terms of her inter vivos trust, then the transfer qualifies for exclusion from change in ownership under Proposition 58 and section 63.1.

The Board has addressed this issue in its LTA 91/08, a copy of which is attached, which provides in part:

"The key to whether a change in ownership occurs when property is distributed according to a trust on a share and share alike basis is whether the trust instrument limits the trustee's powers to distribute property.

"Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

'The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata.' (Added by Chapter 820 of the Statutes of 1986.)

"The statement 'a distribution in kind may be made pro rata or non-pro rata,' means that the trustee has a choice in how he/she distributes non-cash assets, such as real property. The trustee can either give the beneficiaries common ownership in all the assets of the trust estate (pro rata) or can allocate specific assets to individual beneficiaries (non-pro rata).

"California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McClogan (1948) 84 Cal. App.

2d 208. Thus, where the trust instrument conflicts with statutory power, the instrument controls unless a court, pursuant to Probate Code Section [16201], relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including Section 16246.

“Unless the trust instrument specifically states otherwise, the trustee has the power to distribute the trust assets in kind on either a pro rate or non-pro rata basis. Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis can be treated as a direct transfer from parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust’s assets, the trustee has the power to distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may qualify for the parent/child exclusion under Section 63.1.”

In this case, the Trust does not limit the statutory trustee powers contained in Probate Code sections 16220 through 16249. In fact, as indicated above, Article Sixth, Section A, of the Trust provides for the Trustee’s distribution powers similar to but no less broad than those specified in Probate Code section 16246. Also, as indicated above, the Trustee has the power to encumber, mortgage, or pledge trust property for a term within or extending beyond the term of the trust in connection with the exercise of any power vested in the Trustee. This provision is identical to Probate Code section 16228.

It is clear under LTA 91/08 discussed above that where a trustee’s powers are as broad as they are in this case and where the trust requires distribution in equal shares, a trustee may distribute a 100 percent interest in a parcel of real property to a beneficiary without triggering a change in ownership as long as the value of the parcel received by the beneficiary doesn’t exceed the value of his or her share of the trust property. Thus, where the trust property consists solely of two parcels of real property of equal value and the trust requires distribution in equal shares to the two children, the trustee may distribute one parcel to one child and one parcel to the other child without causing a change in ownership as long as the trustee’s statutory powers are not limited by the trust instrument.

Similarly, if the same trust contained one parcel of real property and cash in an amount equal to the value of the real property, no change in ownership would result from a distribution of the real property to one child and the cash to the other child.

This case is different from the latter example only in that the successor Trustee encumbered the Trust real property in order to distribute the trust estate in equal shares by distributing cash to one child and equity in the principal residence of equal value to the other

child. As indicated above, the Successor Trustee had the power to encumber the real property and to make the non-pro rata distribution. In effect, the Successor Trustee exercised his power to encumber in order to be able to exercise his non pro rata distribution power. The creation of a security interest or the substitution of a trustee under a security instrument, if that occurs, is not a change in ownership (§62(c)). Accordingly, it is our view that the distribution made by the Successor Trustee in this case does not result in a change of ownership because the distribution of the real property under the Successor Trustee's powers was a transfer from the decedent to her son "through the medium of an inter vivos...trust" within the meaning of section 63.1(c)(7) and the guidelines of LTA 91/08. The fact that the assessor valued the real property at an amount less than what the Successor Trustee believed the property was worth for purposes of encumbering the property and distributing the trust estate does not change that result. As LTA 91/08 makes clear, where a trustee's statutory powers are not limited by the trust instrument and the trust instrument requires a share and share alike distribution to children, no change in ownership resulting from a transfer between siblings occurs unless a trust beneficiary receives real property valued in excess of the value of his or her share. As pointed out in the example in LTA 91/08, where a beneficiary receives real property which is encumbered, the encumbrance must be considered in determining whether a beneficiary has received real property valued in excess of his or her trust share. In this case, the son did not receive more than his share of the trust estate and, based on the Assessor's valuation, in fact, received less than his share of the trust estate. Accordingly, there was no transfer of real property between siblings and thus, no change in ownership.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Very truly yours,



Eric F. Eisenlauer  
Senior Tax Counsel

EFE:sao

Attachment

cc: Honorable John N. Scott  
Alameda County Assessor

Mr. James Speed - MIC:63

Mr. Dick Johnson - MIC:64

Ms. Jennifer Willis - MIC:70

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Fourth District, Los Angeles  
GRAY DAVIS  
Controller, Sacramento

CINDY RAMBO  
Executive Director

January 23, 1991

TO COUNTY ASSESSORS:

No. 91/08  
CORRECTION

CHANGE IN OWNERSHIP CONSEQUENCES OF REAL PROPERTY  
IN AN ESTATE OR TRUST  
DISTRIBUTED ON A "SHARE AND SHARE ALIKE" BASIS

This letter sets forth the change in ownership consequences of transfers of property from parents to children when property is distributed according to a will or trust and the language of the document directs that the assets of the estate or trust be distributed to the children on a "share and share alike" basis.

Currently, when an estate or trust is to be distributed on a share and share alike basis many assessors presume, for property tax purposes, that the beneficiaries of a trust or the heirs of a will have an equal interest in each and every property owned by the decedent. Consequently, in these counties a change in ownership occurs if any heir or beneficiary obtains an interest in any real property greater than his/her proportional interest in the estate or trust. For example, if property is left to four children and one child is granted a 100 percent interest in the parent's residence, the assessor would have determined that 75 percent of the property interests transferred. Using this policy, the percentage of interests transferred is the amount that the interest in the real property exceeds the proportional interest in the estate.

Our recommendations for the change in ownership consequences of property distributed on a share and share alike basis depend on the provisions of the trust instrument or the will.

TRUSTS

The key to whether a change in ownership occurs when property is distributed according to a trust on a share and share alike basis is whether the trust instrument limits the trustee's powers to distribute property.

Probate Code Section 16200 provides, in part, that a trustee has not only the powers conferred by the trust instrument but also, except as limited in the trust instrument, the powers conferred by statute. Following Probate Code Section 16200 are a number of provisions conferring express statutory powers on trustees. Among those provisions is Section 16246 which provides:

"The trustee has the power to effect distribution of property and money in divided or undivided interests and to adjust resulting differences in valuation. A distribution in kind may be made pro rata or non-pro rata." (Added by Chapter 820 of the Statutes of 1986.)

The statement "a distribution in kind may be made pro rata or non-pro rata," means that the trustee has a choice in how he/she distributes non-cash assets, such as real property. The trustee can either give the beneficiaries common ownership in all the assets of the trust estate (pro rata) or can allocate specific assets to individual beneficiaries (non-pro rata).

California trust law recognizes that the administration of a trust is governed by the trust instrument. Union Bank and Trust Co. v. McColgan (1948) 84 Cal. App. 2d 208. Thus, where the trust instrument conflicts with statutory power, the instrument controls unless a court, pursuant to Probate Code Section 1620.1, relieves the trustee of the restriction in the instrument. Absent a restriction in the trust instrument, the trustee enjoys both the powers conferred by the trust instrument and those conferred by the provisions of the Probate Code, including Section 16246.

Unless the trust instrument specifically states otherwise, the trustee has the power to distribute the trust assets in kind on either a pro rata or non-pro rata basis. Consequently, property in a trust, where the trustee has the power to distribute trust assets on a share and share alike basis can be treated as a direct transfer from parent to child to the extent that the value of the property does not exceed the value of the stipulated share of trust assets. This is because both statutory and case law recognize that, unless the trust instrument specifically states how the beneficiaries are to share the trust's assets, the trustee has the power to distribute property as he/she wishes. Accordingly, the assessor should recognize these transfers of property as a parent to child transfer, which may qualify for the parent/child exclusion under Section 63.1.

#### Example:

A parent leaves a trust estate with a net worth of \$500,000 to his four children on a share and share alike basis. Each child is to receive \$125,000 net worth of assets. The trust document does not limit the trustee's power to distribute the trust assets. Accordingly, as provided by Probate Code Section 16246, the trustee has the power to distribute sole ownership of any asset or a fractional interest in any asset to any of the children.

In distributing the trust, the trustee decides to deed the principal residence, worth \$112,500 and no outstanding loans, to one child. In our view, this would be considered a 100 percent transfer from parent to child which may be excluded from change in ownership under Section 63.1 if a proper claim form is filed. This is because the net worth of the property is under the child's \$125,000 share in the estate. If the property had a net worth which was more than \$125,000, a partial change in ownership

would have occurred. The following example outlines the procedures for such a situation.

If the trustee deeds another child an investment property, with a market value of \$225,000 and an outstanding mortgage balance of \$50,000 (encumbrances in the property should be considered), then a 28.57 percent reappraisable change in ownership would occur. This is calculated as follows: equity in the property minus child's share of the trust estate divided by the equity in the property (\$175,000 - \$125,000/\$175,000). In this case, the equity in the property that the child receives exceeds his/her proportional share of the trust estate by 28.57 percent. In effect, this 28.57 percent interest in the property is a transfer of property between siblings. It does not qualify as a transfer from parent to child since it exceeds the direction that the children share and share alike. Therefore, a 28.57 percent change in ownership of the property has occurred while the remaining 71.43 percent may be excluded from change in ownership according to the provisions of Section 63.1 of the Revenue and Taxation Code.

In practice, assuming a 1975 factored base year value of \$75,000, the new base year value of the property would be calculated as follows:

1975	Factored base year value	\$ 75,000 x 71.43% = \$ 53,572
1990	Market value	\$225,000 x 28.57% = <u>64,282</u>
Value to be enrolled for current roll		\$117,854

#### WILLS

Whether a change in ownership occurs when a child receives a 100 percent interest in real property from a parent's estate when the estate is distributed according to a will on a share and share alike basis depends on whether the will gives the executor a clear grant of broad discretion to distribute property in kind on a pro rata or non-pro rata basis.

Under the Probate Code provisions applicable to wills, the general rule is that a devise of property to more than one person vests the property in them as owners in common. Probate Code Section 6143 provides that unless a contrary intention is indicated in the will, "a devise of property to more than one person vests the property in them as owners in common." See also Estate of Pence (1931) 117 Cal. App. 323, at 331, holding that a devise to more than one person to share and share alike indicates a gift in common. See also Noble v. Beach (1942) 21 Cal. 2d 91, 94; and Estate of Russell (1968) 69 Cal. 2d 200, 214-215.

Of course, many wills contain provisions which grant discretion to distribute property in kind on a pro rata or non-pro rata basis or something equivalent. Probate Code Section 6140(a) states that the intention of the testator as expressed in the will controls the legal effect of the dispositions made in the will. In light of this general principle, a clear grant of discretion to distribute the property in kind on a pro rata or non-pro



TO COUNTY ASSESSORS

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January 23, 1991

rata basis must be given due recognition. In the absence of such a clear grant of broad discretion in the will, however, or an appropriate judicial determination of the meaning of the provisions of the will, assessors are entitled to rely on the general rule set forth in Section 6143 of the Probate Code.

Therefore, if it is determined that the will clearly grants the executor broad discretion in distributing property in kind on a pro rata or non-pro rata basis, the change in ownership consequences are identical to those in the example illustrated for trusts above. If it is not certain or it has not been proved that the executor has this power, then the assessor is correct in allocating an equal fractional interest in each and every property owned by the parent to each child for property tax purposes. It follows that a partial change in ownership will occur if any child acquires an interest in any real property owned by the parent greater than the proportional interest in the estate. It is important to note that the taxpayer carries the burden of proving, to the assessor's satisfaction, that the will in fact grants the requisite discretionary power in distributing the property.

If you have any further questions, please feel free to contact our Real Property Technical Services Unit at (916) 445-4982.

Sincerely,

A handwritten signature in cursive script that reads "Verne Walton".

Verne Walton, Chief  
Assessment Standards Division

VW:sk